



1945

Economic Conditions Governmental Finance United States Securities

New York, August, 1945.

General Business Conditions

THE past month has been an eventful period in the war and in world affairs, with the Pacific fleets of the United States and Great Britain sweeping unopposed along the shores of Japan, the Churchill government overturned in England, the Big Three meeting in Potsdam, ratification by the Senate of the San Francisco charter, and the passage by Congress of the Act providing for participation in the Bretton Woods program. Of these the first two mentioned have had an immediate influence on the economic situation. The demonstration of naval and air supremacy over Japan, with all that it signifies in the way of blockade and destruction, has been so impressive that people naturally think of Japan as nearing the end of her resources; and the stock market sold off on a "peace scare", on the theory that a sudden Japanese surrender would cut off war work abruptly and plunge this country temporarily into unemployment and depression.

The British election, which we discuss on a later page, holds no such direct significance for American business, but here as in London there was in the speculative markets a first reaction of shock and dismay, pending more sober consideration of this momentous news.

The War News and Business

The spread of conjecture as to the length of the war brings to mind the similar speculation, a year or more ago, as to the duration of the European conflict. The people of the United States learned in December 1944 that the end of war is unpredictable. There can be preparation for eventualities, but no relaxation of effort.

Nor is it by any means certain that a bearish interpretation of the economic effect, if the war should end suddenly, is the correct one. Apart from the awful loss of life, the suffering and distress, war represents the greatest waste of wealth and resources, the greatest disruption of the economic and social organization, the greatest piling up of debt and inflationary forces, of which it is possible to conceive.

Every day that it lasts the catastrophe becomes more enormous, and every day that it is shortened, consistent with the aim of destroying the Japanese war-making power, the waste and disruption will be reduced by that much.

These remarks are pertinent not because anyone needs to be persuaded of their truth, but because their significance may be lost sight of through fear of temporary unemployment and depression. In some quarters there is a feeling that in the purely economic sense the country will benefit if the industrial readjustment is cushioned and spread out by tapering war orders, rather than concentrated as it will be if war demands cease abruptly. But this view overlooks the fundamentals, and even for the short run it is open to question. As long as war orders have to be met the "bottleneck" problem will persist. There will be shortages of one or more raw materials, or of one component or another necessary to the production of finished goods, or of key machines. There will be labor bottlenecks, due to scarcity of the right type of worker in the right place. The task of breaking down these bottle-necks in our complex industrial organization is not insurmountable, but we are now learning that it is difficult and time-consuming.

On the other hand, if war work should be terminated all at once, problems that are now acute, such as scarcity of steel sheets, textiles, petroleum products and many others, of machinery and of labor, would be rapidly solved. Enterprise would have greater scope. The preparations in engineering and design, which have made such progress of late, would bear greater fruit. A host of difficulties would disappear.

For these reasons we are of the opinion that even from the narrow viewpoint the country would be better off, and recovery would be further along within a few months, if the inevitable readjustments have to be faced all at once instead of piecemeal. The shock would be more severe and the recession temporarily greater. But reconversion would be more rapid,

the production of peacetime goods would reach volume proportions more quickly, and without question the inflationary menace would be diminished.

The Error in Proposals to "Make Jobs"

If this view is correct it follows that, in the event of a sudden end of the war and a sudden and sharp industrial recession, there should be no effort to provide a substitute for war production by making unnecessary government expenditures through other channels, solely for the purpose of making jobs. Programs for such expenditures already are being proposed, on the ground that employment and income should be "stabilized". But the way to support the impact of temporary unemployment is as provided in the social security program, namely, through the huge reserves now on hand in the state unemployment insurance funds for the purpose.

If makeshift "stabilization" plans should be rushed into operation without giving the industrial organization time to pull itself together, and without allowing the recuperative powers that exist time to exert themselves, they would be harmful rather than helpful. They would interfere with necessary adjustments, prolong the extravagance and waste, and impair genuine recovery. A great danger is that the expenditures would not take effect until the upswing was well under way, when they would compete with the industries for men and materials and intensify the inflationary forces.

The Current Situation

The discussion until now has been in hypothetical terms. Turning to the current situation, business men realize that in overall terms industrial production has entered a decline, due to cutbacks in war plants, and when a decline begins there is always uncertainty as to how fast and far it may go and what the consequences may be on trade and employment. The pessimistic view emphasizes the reconversion difficulties and the multiplied effects of the munitions cutbacks in shrinking orders for raw materials, parts and components. People whose eyes are chiefly on these factors naturally have feared a pronounced drop in the Summer months.

So far, however, the evidence has supported a more optimistic opinion. Trade and employment during July have held up better than many expected, and on the whole the disposition to look on the bright side of the prospect has been strengthened. Orders for steel, copper, zinc and other materials have fallen off, but without much effect on domestic production, which is supported by backlogs of unfilled orders plus a still sizeable current demand. The steel markets, especially for sheets and strip, are still so tight that they are giving

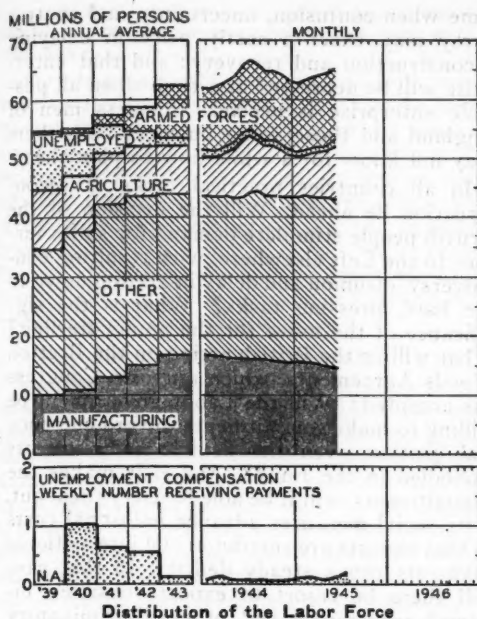
the War Production Board great concern, for cancellations of outstanding orders have not been in proportion to cutbacks in war contracts, and the offerings on which WPB has counted to take care of civilian production are not up to expectations.

Whatever the cause, the real significance of the situation seems to be that manufacturers want steel. They want to keep what they have, so far as WPB regulations permit, and they are anxious to get delivery promises for the materials they will need later when they can get back in civilian production. There is no weakening of steel scrap prices below the ceiling, such as occurred last Fall. There is no letup in the demand for fuel, and little if any slackening in the use of electric power. These facts argue against a decline this Summer as severe as some have feared, and with each month that passes the time comes closer when reconverted industries will be in shape to go ahead, and when expansion in civilian output will compensate for cutbacks in war plants to a greater extent than is now possible.

Trade and Employment Figures

Merchants are mindful that they must not be caught with larger inventories of inferior goods than they can help, but their buying policies are still governed more by what they can get than by any other factor, and trade in many respects is all they could desire. Department store sales in the first three weeks of July averaged 20 per cent above a year ago. Rising department store inventories continue a surprising feature of the retail reports; at the end of June they were 15 per cent above last year. The increase is further evidence of the ingenuity and resourcefulness with which manufacturers have supplied consumer goods to the stores during this war. Of course "trading up" to higher priced merchandise is a factor in inventory valuation, but probably no more so than a year ago.

Other figures which throw light on the current situation are the statistics of employment. The trend of employment in non-agricultural occupations has been downward with a drop of 60,000 from the middle of April to the middle of May, and a further decline of 450,000 to mid-June, according to the estimates of the Census Bureau. In both months, however, this drop was more than offset by the seasonal increase in agricultural employment, and total employment rose. Calculated unemployment in the middle of May was practically at the low point of the war period at 730,000. It rose in June to 1,080,000, but in interpreting this figure the increase in the labor force during the school vacation season is to be taken into account. The accompanying chart diagrams these figures. It shows the declining trend of non-agricultural employment, as well as the



Sources: Bureau of Labor Statistics, Bureau of the Census, Social Security Board, War Manpower Comm.

seasonal rise in total employment and in the labor force.

The War Manpower Commission has been quoted as expecting that unemployment in August may reach 2 million. This is a moderate figure. It is substantially below what most students of the question consider a peacetime minimum for this country,—usually placed at $2\frac{1}{2}$ to 3 million,—for there are always people out of work because of seasonal or other temporary conditions, because they are changing jobs, or simply because they want to loaf for a while. Obviously much of the unemployment this Summer is voluntary in nature, for it is common observation that trades, services, and even many industries—including the textile mills, the mines, the railroads and the lumber camps—are understaffed. Although it may not be practicable for a worker who loses a job in a Detroit war plant to take one on a western railroad or in a southern textile mill, there is work to be had in trade and services almost everywhere. But there is general testimony that the workers released from war plants are not taking these jobs, whether because of dislike or unsuitability, lower wages, or merely inclination to rest and live on savings for a while after the years of long hours in war work.

The "evaporation of the labor force" is a phenomenon upon which all observers comment. Many workers who leave war plants disappear from the area. They go back whence they came or move on for a change of scene. Housewives go back into the home. It is strik-

ing that although 1,080,000 were unemployed in the middle of June, only about 250,000 were on unemployment insurance compensation rolls, either as recipients of compensation or as claimants. Evidently workers move on without regard to claims or would rather forego compensation than assume an obligation to take another job if it is offered.

How long this "evaporation" will last, or workers' resources will permit it to last, remains to be seen. It is understandable after the hard work of war production, and in the long run it is desirable that the labor force should shrink, through return of young people to school, housewives to the home, and retirement of older people. Nevertheless, there has never been such need of everything the country can produce, not only of the critical war items, but of the civilian goods that are so desperately wanted to get the economy functioning normally, raise the standard of living, and overcome the menace of inflation.

The British Elections

The sweeping victory of the Labor party in the British elections was a stunning surprise in this country, for advices from abroad had indicated that an overturn was not likely. It is difficult even in our own elections to determine what influences actually govern voters, and of course it is more difficult to comprehend all the political and personal factors that enter into an election in another country. The Conservative party had been in office ten years, including nearly six of war, and any party in power under such circumstances becomes the target of accumulated grievances and complaints, which may have influenced the voters as much as or more than study of postwar issues. We are familiar in this country with changes of administration after a war and at other critical times.

The Conservatives were on record as endorsing the White Paper of May 26, 1944, which recommended government acceptance of responsibility for "a high and stable level of employment after the war" and proposed radical measures to that end. They sponsored a housing program, extension of social security and national health service, and other measures on which the British people for the most part are agreed. The Labor party, however, promised all this and much more.

The Labor Program

The platform of the Labor party is contained in the statement entitled "Let Us Face the Future", which was drawn up last April by a committee headed by Herbert Morrison, and approved by the annual conference of the party in May. The program includes—in addition to expanded social security and health meas-

ures and "jobs for all" — public ownership of the fuel and power industries, inland transport, iron and steel, and the Bank of England. It includes "planned investment" for both industrial and social purposes and a Board to "determine social priorities and promote better timing in private investment." It includes "suitable economic and price controls" to keep down living costs and give priority to production of necessities. A "full program of land planning and drastic action to ensure an efficient building industry" is pledged, and it is declared that "Labor believes in land nationalization and will work towards it."

Above all, the program declared that Labor will do what it promises. "The nation needs a tremendous overhaul . . . All parties say so — the Labor party means it." "Everybody says that we must have houses. Only the Labor party is ready to take the necessary steps." "The Labor party is a Socialist party, and proud of it."

Insofar as postwar policy was the issue, therefore, it was one of the degree of control and overhead planning to be enforced by the State, the amount of economic activity to be carried on by the State, and the extent of individual benefits to be sought from the State. Mr. Churchill warned that the Labor proposals meant the loss of freedom of economic action and probably, in the end, of political liberties. He drew a vivid picture of the eventual regulation of daily lives and pursuits, and of rampant inflation. The Labor leaders ridiculed these fears and obviously the voters were not impressed. The outcome shows that the voters are not afraid of a possible vast extension of state intervention, for purposes which they believe to be beneficent. At any rate, they preferred to put their trust in new faces and new ideas.

It should be said that by no stretch of the imagination can the result be considered a repudiation of Mr. Churchill's leadership during the past five years. His stature as a war leader can never be diminished, and his place in history is unique and secure.

Implications of the Change

It is a momentous step for a country with the long tradition of liberty and free enterprise of Great Britain to entrust its government to a party of socialist doctrines, and reactions will be felt far beyond Britain's borders. There are some who hold that the situation will be benefited by government taking wider control, on the ground that the problems of Great Britain, as of Europe generally, are too vast to be solved by reliance on private initiative. The opposing view is that the change of government and of policy adds another element to the confusion in world affairs at a

time when confusion, uncertainty and controversy may exact a costly price in delaying reconstruction and recovery; and that enterprise will be depressed at a time when all possible enterprise is needed. Business men of England and those doing business with them may not know for a while how to plan ahead.

In all countries practical tasks of reconstruction lie ahead. Will the decision of the British people stimulate demand for shifts further to the Left elsewhere, with resulting controversy, disunion and delay in getting down to the hard, pressing tasks? What is the significance of the move for the pound sterling? What will be the British action on the Bretton Woods Agreements, which our own Congress has accepted? Will the Labor government be willing to make commitments toward currency stabilization, even the flexible commitments embodied in the Fund? And if it makes the commitments, will it be able to carry them out, if its social measures advance industrial costs so that exports are restricted and international payments run a steady deficit? In that case will there be resort to export subsidies, bilateral agreements and other discriminatory measures of which the world should rid itself?

We published in this Letter last month an article describing the problems of the British balance of payments, which for solution will require hard work, rigid limitation of imports to necessities, emphasis on exports at the expense of domestic consumption, and efficient low-cost production in the export industries. Can these be immediately reconciled with the promises of high wages and great advances in social welfare? What will be the effect of nationalization and of extended business controls on productivity?

Factors of Reassurance

These are grave questions to which events must supply the answer, and it would be wrong to prejudge them. Fortunately there are many factors of reassurance. The men who will hold the principal positions in the Labor government will be the same men who have been serving ably in the Coalition government. Their sense of responsibility is unquestioned. There appears little likelihood that the extreme Leftists will exert major influence. Writing in "Foreign Affairs", July 1945, A. L. Rowse of Oxford University says of the Labor party:

Thirty years ago it was the party of the dispossessed. The working classes were kept outside of political and economic power. That generated an immense drive for social and economic justice. The party was a radical party with an aggressive, aggrieved outlook . . .

Things have changed since those good (or, according to taste, bad) old days. The party has lost much of its former crusading, propagandists' fire . . . The fact is that nobody can pretend that the working class has not got substantial social justice in England to-

day . . . It has ceased to be a party of radical social criticism. It has become more responsible, more governmental.

There is a vast gulf between a radical program carried out ruthlessly and ineptly and one put into effect by experienced and sober-minded people, feeling their way carefully and dealing fairly with all affected. In foreign affairs Mr. Attlee's first statement was that the government would prosecute the war against Japan vigorously, and it will work both through the Big Power conferences and through the United Nations organizations to promote peace and reconstruction.

Can the Aims Be Realized?

Whether the Labor government will realize its social aims must depend in last analysis upon the ability of the British economy to yield and pay for the benefits which so many of the British people expect to receive. That in turn depends upon productivity. If the effort to provide "a high and constant purchasing power . . . through good wages, social services and insurance, and taxation which bears less heavily on the lower-income groups" (the quotation is from "Let Us Face the Future") is pushed faster than the economy can support it, the value of the "purchasing power" distributed will be illusory, for it will be lost through unemployment or through inflation, perhaps both.

At the close of the last war Mr. Lloyd George in his successful campaign for re-election made an address from which an extract is worth reading now:

You cannot have improved wages and improved conditions of labor all round unless you manage to increase production . . . There is one condition for the success of all efforts to increase the output of this country — confidence . . . You must give confidence to all classes, confidence to those who have brains, to those who have capital, and to those with hearts and hands to work. I say to labor, you shall have justice; you shall have fair treatment, a fair share of the amenities of life, and your children shall have equal opportunities with the children of the rich. To capital I say: You shall not be plundered or penalized; do your duty by those who work for you, and the future is free for all the enterprise or audacity you can give us . . . And when the whole nation sees that wealth lies in production, that production can be enormously increased, with higher wages and shorter hours, and when the classes feel confidence in each other, and trust each other, there will be abundance to requite the toil and to gladden the hearts of all. We can change the whole face of existence.

Mr. Lloyd George offered a great deal, but only, it will be noted, in return for production. On that the Labor program eventually must stand or fall. If it fails it will be because it attempts more than can possibly be fulfilled, in light of the facts and circumstances which face Great Britain now and in the years ahead.

An interesting comment made in this country on the election has been reported in the

New York press. Senator Aiken of Vermont is quoted as saying he believed "that the presence of two million American soldiers in the British Isles must have opened the common people's eyes when the G I's referred to the homes and cars and other conveniences back home."

But the thought prompted by this statement is that the homes and cars, the modern conveniences, and other evidences of high living standards in the United States, as described by the G I's in Great Britain, are the achievement of a long history of free enterprise, not of state planning or control; and of a system of private enterprise, not of state management or nationalized industries.

Progress of French Reconstruction

Recent reports from the liberated countries in Western Europe show that the difficulties of reconstruction have not been underrated. In some respects conditions are better than the early reports indicated. There appears to be less physical destruction than feared, food is plentiful in many country districts though scarce in cities, and restoration of transportation and communication has made headway. But progress in most ways has been slower than hoped for. Industrial facilities are being only partially utilized because of fuel, manpower and raw material bottlenecks, and the prospect is for crops smaller than last year. Goods of many kinds have almost disappeared. Even with the aid of overseas supplies the people face another hard winter without adequate protective foods, clothing, and fuel.

In all these countries it is now seen that reconstruction is not wholly or even chiefly a matter of restoring physical facilities. It is also a process of reestablishing the economic, social and political organizations, getting wheels turning and starting up the flow of trade. It requires cooperation, unity, confidence and enterprise. Inevitably four years of German occupation, followed by almost another year of continued warfare, caused a partial paralysis of national life. Individuals have been preoccupied with the elemental task of keeping alive, and find it understandably hard to face and solve the more complicated problems of reestablishing a working organization. Many are still numbed by suffering and by the vastness of the difficulties. Even though they realize that all must work together they do not understand what they as individuals can do or see where they can start, and in many cases the energy or will to cooperate is lacking. This is not said in condemnation, but in sympathy. Lack of understanding of the cooperative nature of all economic and social effort, and inability to work together, are not confined to the distressed countries of Europe, but are met in places where there is far less excuse.

There are demands in all liberated countries for readjustments and reforms, and some elements have been advocating far-reaching political, social and economic changes. Uncertainty as to the political and economic framework in which business is to work in the future has discouraged incentive and retarded recovery, — at a time when the crying need is not a revolution in the social system, but food, goods and employment.

Industrial Bottlenecks in France

France, as the largest political and economic unit west of the Rhine, in many respects supplies the key to the recovery of Western Europe. France was the first continental country to be liberated and the process of rehabilitation there has gone probably further than elsewhere. But France has found it a hard pull to reorganize her economy and to increase her production. The overall rate of industrial activity, which last Spring was estimated at about 30 per cent of the 1938 figure, has apparently not risen appreciably since.

The principal physical obstacles to the increased output of goods are the shortage of coal and raw materials. Although the coal mines have been recovered almost intact, production has been low because of shortage of miners, lack of equipment and pit props, and low man-hour output, variously attributed to absenteeism, undernourishment of miners, and nationalization policies. The current rate of production is around 25 to 30 million tons, compared with 45 million before the war. Including coal imports, now suspended, French peacetime requirements were about 70 million tons. As the situation stands, industries and home users will have, after providing for military and other priority uses, about one-fourth of their normal peacetime needs. To increase the coal supply German war prisoners and repatriated workers will be employed, but the best prospect apparently lies in stepping up production in the Saar Basin, where the mines seem to have been only slightly damaged but are seriously undermanned.

Another serious bottleneck, the shortage of industrial raw materials such as textile fibers and rubber, is at present overshadowed by the coal crisis. Supplies of fibers will probably be forthcoming. However, replenishment of textiles, household articles and other consumers' goods, depleted by an estimated Fr. 50 billion during the German occupation, will take a long time. Meanwhile the reequipment of the French army, which has first call on production, is further limiting the meager supply of goods available to the consumer.

Shortage of fertilizers, draft animals, and fuel has kept output of food down, and scarcity of manufactured goods and equipment has also been an important factor. Farmers have

been reluctant to sell for paper money, with which they can buy very little, and instead have been consuming more of their products themselves. As a result, collections have been disappointing and food distribution very uneven. Unless more industrial goods are available next year, stimulus to increase agricultural production will be lacking.

Uncertainty as to the Future

Apart from industrial bottlenecks, the resumption of more normal business activities has been hindered in France, as much as anywhere in Western Europe, by the absence of a clear-cut, consistent reconstruction program which would enjoy wide public support. In the revolutionary atmosphere of the liberation, a unified policy has been naturally slow to emerge. Although the fundamental problem was to increase the supply of goods, other and sometimes conflicting objectives were also sought. Hope of quick relief through food and raw materials from outside — which the Allies could not give for many reasons — and ambitious plans for sweeping social and economic reforms have both weakened production incentives.

The Provisional Government itself has made the important decision that the foremost need of France now is to get inflationary forces under control, check them in their upward spiral, and avert a runaway and collapse. To that end proposals for nationalization of industries and similar programs are being held in abeyance, and M. Mendès-France, the Minister of National Economy who sponsored these "planned economy" ideas, resigned last April. However, there will be no real assurance as to future policy at least until the elections are held in October and a government having the direct mandate of the people is established. Meanwhile the average French business man is hesitant about planning for the future, and the re-entry of foreign capital has been delayed by the uncertainty regarding nationalization and the withdrawal of profits. Thus France is caught in a vicious circle. The danger of social and economic radicalism is bound to mount with suffering caused by shortage of goods; yet without government policies inspiring confidence the spirit of enterprise is weakened.

The Decision to Fight Inflation

To the task of arresting inflation the Minister of Finance, M. René Plevin, who also assumed the Ministry of National Economy after the resignation of M. Mendès-France, has addressed himself vigorously. His basic program is to attack the problem at both ends, — to secure a better balance between the supply of goods and purchasing power by concentrating on increasing production, on the one hand, and reducing the money supply, on the

ther. He has recognized that prices must reflect costs and must not restrict production, and one of his first steps was to remove the requirement that industries had to maintain prices on the level prevailing at the time of liberation. This change allowed them to pass to the consumer at least some of the increased costs, although many firms had lost a substantial part of their cash resources or working capital in the meantime.

French production costs have risen substantially since the liberation, not only because of the rise in wage rates, but also because of a law requiring industrial enterprises to pay up to 75 per cent of the wages of workers laid off. Since the liberation wages have been raised twice and are now three to four times as high as before the war. With the production of foodstuffs insufficient and black market prices from three to eight times as high as in 1938, the pressure for further wage increases continues. Experience in all countries shows that this pressure upon costs is the gravest danger that the economy faces.

The Census of Wealth

The efforts of M. Pleven to reduce the volume of money have centered largely around plans for prevention of tax evasion, for confiscation of illegal and collaborationist profits, and above all, for a capital levy and a war profits tax. To obtain a just basis for such a measure, the French Treasury has been gathering information step by step on individual and corporate wealth and income, both at home and abroad. Finally, during the early part of June the Government undertook a major operation. All paper currency with a face value of more than 25 francs was called in for exchange for new notes. This move had a dual purpose: first, to list individual holdings; second, to discourage hoarding and reduce the currency supplies on which the black market depends. At the same time, short-term Treasury bills were called in for stamping and registering; being issued to bearer and easily negotiable, they were a favored investment during the war and their volume equalled almost that of note circulation.

The exchange of notes produced some interesting results. Some 10 per cent, or Fr. 50 billion, of old bank notes, probably representing for the most part cash taken out by the Germans, have not been turned in. The total outstanding circulation has now been reduced to less than Fr. 400 billion (\$8 billion) from Fr. 590 billion in May and Fr. 630 billion last October. It is now roughly three times as high as before the war. But while circulation has declined, total deposits have reached the record level of Fr. 690 billion, increasing by some 210 billion in about one month.

Capital Levy Proposed

With the census of wealth taken, M. Pleven proposed early last month — and the Consultative Assembly approved July 30 — a capital levy consisting of two parts: (1) a straight levy on current net wealth, and (2) a special levy on the increase of wealth between January 1940 and June 1945. The levy on net wealth would rise progressively from 3 per cent on smaller fortunes to 20 per cent on amounts exceeding Fr. 300 million after allowing certain exemptions. It would be paid in four installments in the 1946-49 period, and M. Pleven estimated in his Budget speech that it would bring between Fr. 100-125 billion.

The levy on wartime increments of wealth would be paid in 1946. It would also be progressive, rising from 20 per cent on smaller fortunes to 100 per cent on amounts exceeding Fr. 5 million, after allowing exemptions. As to corporations, those with stock listed on the Bourse and capitalized at above Fr. 40 million are under obligation to reduce their capital by 5 per cent and to reissue new shares to the extent of 5 per cent to the Treasury. The calculation of exemptions is complicated and the plan is accompanied by a number of fiscal reforms. In the Assembly debate the Right maintained that the levies would destroy the incentive to save and depress enterprise, while the extreme Left demanded still more drastic action, but the final vote was 233 to 2 in approval.

A capital levy is a dangerous instrument of finance. It discourages saving rather than spending, since people fear the levy may be repeated. Thus it is destructive of growth and progress. It taxes capital not at the time of accumulation, but at a time when it may already be in productive use, either as equipment, buildings, or working capital. In that case it can be paid only by liquidation of the investment, which may be practically impossible at a time when liquid capital is being taxed away, or by borrowing. If business has to borrow to pay a capital levy, there is no net gain in the fight on inflation. Presumably in France, where there was considerable tax evasion under the Vichy rule, and where wartime profits are still highly liquid because opportunities for their investment in business have been small, a case can be made for a levy on a wartime increment of wealth. Nevertheless, it will inflict hardships and reduce the supply of capital on which the industrial progress of the country depends.

Recuperative Potential Large

In considering the multitude of problems facing France today, sight should not be lost of the fact that she is fundamentally a rich country, with well-balanced natural resources and a hard-working, thrifty populace, and that

she already has made a considerable comeback despite the hardships suffered under German occupation. The communication difficulties which brought her industries and distribution to a practical standstill last Winter are on the way to solution. Harbor facilities are now sufficiently restored to handle more than peacetime tonnages. Moreover, France has retained a greater part of her prewar gold and foreign exchange assets, and she will also benefit from a Lend-Lease arrangement with this country equivalent to a long-term loan of some \$2½ billion. She has now accumulated some shipping of her own, and imports of the raw materials with which the world is well stocked, such as cotton and wool, are on the increase. The decision to hold the election this Fall rather than to wait until next year is also an important constructive development, since it will eventually remove the uncertainty in regard to the future government policies and enable business to plan accordingly.

Thus there is no reason to despair of the outcome of the French difficulties. The situation illustrates, however, the magnitude of the problems of the liberated countries, the necessity of understanding and the will to work, and the great influence that political policies and political controversy may have upon the rate of recovery and reconstruction.

The Half Year's Earnings

Corporate reports for the first half year reflect the continued high wartime level of activity that prevailed in most lines of business during the period, and show that cutbacks made in the war program since V-E Day had little effect on the half-year's returns. Sales

figures of a few manufacturing corporations for the first six months showed substantial decreases as compared with the same period last year, but about two out of every three companies reporting sales had increases, and the combined total of sales was practically the same as a year ago.

A tabulation of the earnings reports of 320 industrial companies issued to date shows combined net income after taxes of approximately \$688 million for the first half year, compared with \$615 million last year, an increase of 12 per cent. As in the case of sales, the net earnings of almost two out of every three companies showed increases over last year. This group, representative mainly of the country's larger manufacturing enterprises, had an aggregate net worth of \$14,331 million at the beginning of 1945, upon which the half year's net income was at an annual rate of return of 9.6 per cent, compared with a net worth of \$13,770 million last year and a return of 8.9 per cent. The interim earnings, as reported by the companies, are subject to the renegotiation of government contracts as well as to the usual year-end adjustments and reserves. A summary by major industrial groups is given in the accompanying table.

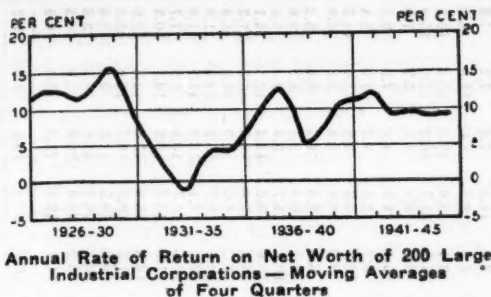
Quarterly figures available from 270 companies show that net income after taxes in the second quarter this year was slightly higher than in the first, and about 12 per cent above the second quarter 1944. The quarterly trend of earnings over a period of years is indicated by the following chart, based upon a group of 200 large industrial corporations. Figures for the quarter just closed are partly estimated.

NET INCOME OF LEADING CORPORATIONS FOR THE HALF YEAR

Net Income is Shown After Depreciation, Interest, Taxes, and Other Charges and Reserves, but Before Dividends—Net Worth Includes Book Value of Outstanding Preferred and Common Stock and Surplus Account at Beginning of Each Year.
(In Thousands of Dollars)

No. of Cos.	Industrial Groups	Net Income Half Year		Per Cent Change	Net Worth January 1		Annual Rate of Return %	
		1944	1945		1944	1945	1944	1945
24	Food products	\$ 40,670	\$ 48,152	+18.4	\$ 852,315	\$ 863,647	9.5	11.2
15	Textiles and apparel.....	8,836	8,360	+22.3	173,406	189,208	7.9	8.8
17	Pulp and paper products.....	8,650	8,667	+ 0.2	246,069	254,338	7.1	6.8
30	Chemicals, drugs, etc.	76,076	80,306	+ 7.0	1,400,014	1,488,773	10.7	10.8
10	Petroleum products	129,061	157,881	+22.3	2,731,735	2,879,113	9.4	11.0
8	Stone, clay and glass.....	16,133	16,243	+ 0.7	314,058	324,433	10.3	10.0
28	Iron and steel	75,714	84,600	+11.7	3,299,070	3,266,039	4.7	5.2
7	Electrical equipment	25,585	28,823	+12.7	376,777	401,334	13.6	14.4
27	Machinery	21,832	19,879	- 8.9	367,024	445,856	11.9	8.9
24	Autos and equipment.....	100,928	108,272	+ 7.3	1,550,533	1,599,342	13.0	13.5
54	Other metal products	35,691	39,035	+ 9.4	817,333	846,125	8.7	9.2
23	Miscellaneous mfg.	33,771	40,720	+20.6	559,505	604,240	12.1	13.5
267	Total manufacturing	569,946	640,938	+12.5	12,626,839	13,162,448	9.0	9.7
26	Mining and quarrying	28,492*	28,522*	+ 0.1	701,801	733,076	8.1	7.8
18	Trade (whol. and retail).....	11,251	13,256	+17.8	301,785	299,497	7.5	8.9
9	Service	5,129	4,875	- 5.0	139,855	136,166	7.3	7.2
320	Total	\$614,818	\$687,591	+11.8	\$13,770,280	\$14,331,187	8.9	9.6

* Before depletion charges in some cases.



The unusual stability of earnings during the period 1943-45, at a level moderately below that of 1940-42, is due to a number of factors including the high corporate income and excess profits tax rates, renegotiation of government contracts, and fixed prices on raw materials and finished products. Moreover, for the group taken as a whole, the wartime increases in earnings of some companies have been offset by decreases of others. For the manufacturing industries generally, the tremendous expansion in volume of production and sales, adoption of two-shift and three-shift operations, and use of plant and equipment at practically full capacity, have made possible the absorption to a large extent of the substantial and continuing advance that has taken place in labor costs.

The Problem of Costs and Prices

With the vast war contracts now tapering off sharply, the relationship of industrial costs and prices has become a problem second in importance only to that of winning the war. During wartime the prime consideration is output rather than cost, and the principal buyer is the Government, with almost unlimited powers of taxation and borrowing. In peacetime, however, production in most lines will be at a lower level, which will tend to raise certain unit costs correspondingly. Concerns selling in the competitive civilian markets will need profitable price-cost relationships, if they are to contribute their share toward the national goal of large-scale employment. If labor costs are too high, or ceiling prices are too low, relative to each other, the inevitable result would be unemployment, leading to pressure to readjust costs downward or prices upward, or both.

Termination of war contracts and the re-conversion already under way in many plants have made determination of specific prices under the O.P.A. formulas a matter calling for action immediately or in the near future. Backlogs of unfilled orders on the books of manufacturing companies are now being cut away by contract cancellations as well as by heavy current shipments,—that of General Motors Corporation dropping from \$3,690 mil-

lion on March 31 to \$2,520 million on June 30. Such curtailment of new business, although not revealed in any considerable degree by our tabulation of corporate reports covering the first half year, may be expected from now on to become an increasingly important influence upon the course of employment, industrial production, and earnings.

Long-Term Trend of Manufacturing Earnings

Tabulations of the annual earnings of leading corporations have been presented regularly in the April issues of our Bank Letter beginning with the year 1928. Since publication of these figures began our readers' interest in them has grown steadily. They are widely quoted, and we receive numerous inquiries from students for data for earlier years, which would throw additional light on earnings in different phases of the business cycle and on the diverse trends among major industries. Because of the need for figures covering a larger part of the late 1920s, our series recently was worked back for 1925-27 and the totals but not industry group details, were given in our March 1945 issue.

A comprehensive summary is now given, on the next page, of the average rates of return on net worth of forty-five manufacturing industry groups during the twenty-year period 1925-44. These rates represent the percentage of net income after taxes to the book value of outstanding capital and surplus at the beginning of each year. Figures since 1928 are taken from tabulations previously published, except for a few recomputations necessitated by changes made in the industrial classifications.

While these annual tabulations, based upon the relatively limited number of companies issuing public reports, indicate general trends, they do not—as has been pointed out repeatedly—provide an exact measure of "average earnings" for entire industries or for business as a whole. The only complete record is that contained in the Treasury Department annual "Statistics of Income," compiled since 1916 from the tax returns of all corporations in the United States and giving detailed income, expense and balance sheet data, broken down into a great many industrial groups and sub-groups. These statistics, however, do not become available until a considerable time after the corporate reports to shareholders have been published. The Treasury reports may be purchased from the Government Printing Office in Washington, D. C., and are on file in reference libraries throughout the country. A condensed summary for all active manufacturing corporations (now around 84,000) for the years 1925-41 was given in our March 1945 issue.

AVERAGE ANNUAL PERCENTAGE RATES OF NET INCOME AFTER TAXES TO NET WORTH OF LEADING MANUFACTURING CORPORATIONS FOR THE YEARS 1925-1944

Net income is taken as reported, after depreciation, interest, taxes, and other charges and reserves, but before dividends. — Net worth includes book value of outstanding preferred and common stock and surplus account at beginning of each year. — The percentage rates indicate general earnings trends, but are not strictly comparable over a period of years because of (1) variation in number of available corporate reports included in the different annual tabulations upon which this summary is based, and (2) certain changes in industrial classification during the period.

No. of Cos.-1944	Industrial Groups	1925	1926	1927	1928	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938	1939	1940	1941	1942	1943	1944
20	Baking	15.4	13.6	14.7	14.7	15.5	13.5	11.0	7.6	7.1	5.9	5.5	8.2	7.6	8.8	8.7	7.6	7.4	9.3	9.9	9.2
14	Dairy products	16.5	19.9	16.3	20.0	21.5	17.8	12.2	6.2	4.2	4.8	5.9	9.8	7.8	8.4	9.9	9.1	10.2	10.0	11.0	11.0
15	Meat packing	5.7	5.2	2.0	5.9	5.5	4.1	-1.2	-0.3	3.6	3.3	4.5	5.5	2.2	-1.0	4.9	5.6	8.8	8.3	7.9	7.6
23	Sugar	3.4	2.1	4.4	4.7	3.2	0.7	0.1	0.5	4.4	11.9	10.1	12.0	9.8	9.8	4.1	4.8	5.7	10.4	6.2	10.1
61	Other food products	13.9	14.4	14.5	16.7	16.5	11.9	8.4	5.6	9.4	11.9	10.1	12.0	9.8	9.8	10.3	10.9	11.9	10.2	10.7	11.1
19	Soft drinks	21.9	23.7	25.1	26.0	27.1	23.6	18.0	10.6	11.8	18.7	20.1	25.7	38.5	36.5	37.5	33.9	35.5	26.5	23.0	21.8
26	Brewing	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•
8	Distilling	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•
20	Tobacco products	13.4	14.0	14.4	13.2	14.2	14.5	14.4	13.4	8.3	10.7	10.6	12.8	12.9	12.4	13.1	13.7	11.7	10.5	9.8	9.3
41	Cotton goods	2.0	-0.3	5.9	3.7	4.0	-4.3	-5.0	-3.9	4.1	1.9	-2.8	5.4	4.7	-2.2	3.6	5.4	12.1	10.4	8.4	7.1
12	Silk and rayon	7.6	4.9	5.5	6.2	2.8	-1.4	-0.7	-1.4	10.7	3.6	8.1	8.7	11.1	11.1	11.5	11.5	9.7	8.6	7.5	6.9
7	Woolen goods	-0.4	-5.5	-1.7	-1.2	-3.7	-5.9	-3.1	-10.4	10.3	-7.2	4.0	4.8	-0.9	-6.7	4.3	5.7	11.8	9.2	9.1	8.3
16	Hosiery knit goods	12.9	11.0	9.9	11.8	12.6	2.3	-0.9	-2.9	3.2	2.3	4.7	6.9	7.0	4.9	7.9	5.2	11.8	10.6	9.6	9.7
36	Other textile prod.	10.5	6.9	9.0	8.9	8.8	1.3	0.1	-3.7	4.3	2.6	6.2	11.8	8.8	-0.1	8.9	11.6	13.3	10.3	9.2	8.9
23	Clothing & apparel	9.9	11.1	12.4	13.0	11.8	3.8	-1.8	-4.9	2.7	3.7	6.1	9.1	9.1	6.4	10.4	9.9	11.4	11.0	11.6	9.5
9	Leather tanning	3.2	0.7	5.2	4.5	-5.6	-7.2	-5.5	-7.3	9.5	-3.0	5.7	4.4	2.4	8.4	-0.5	7.7	4.6	10.8	11.0	10.3
18	Shoes, leather prod.	13.8	12.3	16.6	13.3	13.1	7.1	5.5	2.3	6.9	7.9	8.1	9.8	9.1	7.1	4.0	6.9	7.7	10.5	9.8	9.1
22	Rubber products	14.3	5.2	9.0	0.7	3.9	-3.1	-1.2	-2.8	2.4	2.4	2.4	4.1	9.8	6.4	5.1	9.4	11.4	10.3	13.1	11.8
20	Lumber	7.4	6.3	4.8	6.2	5.9	-2.5	-10.0	-8.5	-3.3	0.0	0.9	3.9	3.9	6.8	0.5	4.1	7.6	16.3	11.8	8.4
12	Furn., wood prod.	10.1	6.1	4.9	6.6	5.2	-5.1	-7.8	-8.3	2.4	2.6	7.0	13.1	12.1	1.4	8.6	10.2	11.0	6.9	5.2	8.2
74	Pulp & paper prod.	6.1	5.5	6.2	8.0	12.0	3.0	-0.6	-2.2	0.0	2.6	3.3	4.0	7.5	3.0	6.4	9.6	10.5	7.6	7.2	7.3
23	Printing & publish.	15.5	15.0	15.9	20.4	21.5	15.1	9.6	5.0	2.9	7.7	9.1	13.3	8.2	4.6	7.2	8.8	8.5	8.0	11.6	10.2
54	Chemical products	8.6	10.5	10.3	17.2	18.0	11.4	8.0	4.9	8.0	9.6	11.8	15.2	14.7	7.9	12.9	13.1	13.6	10.8	10.4	10.6
25	Drugs, soap, etc.	19.7	20.5	21.3	20.9	23.7	19.2	15.8	8.8	12.3	15.1	14.3	17.4	18.4	15.1	19.6	21.7	21.5	16.2	17.4	15.9
18	Paint and varnish	9.9	11.5	7.9	12.4	13.4	2.4	3.4	0.0	6.4	6.7	8.9	11.5	8.4	8.4	8.1	8.0	9.7	7.0	6.7	7.9
39	Petroleum products	11.6	11.3	4.7	10.3	10.8	4.4	-1.5	0.9	1.4	2.6	4.8	7.8	10.0	5.0	5.4	5.4	9.9	7.0	7.9	9.7
17	Cement	17.1	12.5	8.8	9.1	6.7	5.4	-1.4	-4.7	-2.1	1.3	0.7	7.0	5.5	8.7	7.1	6.7	8.6	7.1	4.0	1.8
9	Glass products	11.9	11.8	7.9	7.9	10.9	5.1	2.5	1.5	9.4	8.9	14.8	17.3	17.4	7.2	12.1	12.9	13.3	9.3	11.4	11.5
36	Other stone, clay pr.	10.5	10.8	9.6	8.5	9.0	4.7	1.1	-3.5	-0.2	2.4	5.3	8.7	8.7	3.7	8.3	9.2	10.8	8.6	7.2	6.9
54	Iron and steel	5.8	7.3	5.3	7.0	11.2	4.5	-0.5	-4.0	-1.9	-0.4	1.3	4.7	4.9	-0.2	4.5	8.5	9.6	6.5	5.6	5.2
12	Agricul. implements	8.3	10.4	10.0	12.0	13.4	8.8	-1.0	-5.2	-2.8	0.6	7.7	12.2	13.1	6.6	5.1	8.5	10.6	9.1	8.5	8.6
42	Bldg., heat, pub. eqp.	15.0	13.9	10.7	12.1	14.2	4.8	-2.2	-6.3	-1.6	1.2	3.6	8.8	10.1	0.4	6.6	10.4	11.7	9.6	9.4	9.4
58	Electrical equipmt.	12.9	13.9	13.4	15.8	17.7	9.3	4.1	-2.5	-1.6	2.2	5.5	11.5	16.2	6.7	10.5	15.5	15.6	11.4	12.4	13.1
48	Household and tools	14.3	16.3	14.8	18.4	15.7	4.4	-5.6	-6.3	-0.2	3.5	5.9	12.9	14.6	6.1	11.7	12.3	16.0	10.0	10.5	11.3
31	Household equipmt.	15.6	16.1	14.0	14.5	14.7	7.7	1.8	1.3	6.1	7.2	8.3	12.9	14.5	5.2	8.6	14.6	19.7	15.9	14.8	11.8
17	Machinery	8.8	10.4	8.0	11.0	14.3	5.5	-1.6	-7.3	-4.0	1.1	5.4	11.7	14.5	20.2	10.2	10.4	12.4	17.1	13.8	11.2
21	Office equipment	12.4	13.2	14.7	17.4	21.1	12.0	4.7	-1.9	3.6	9.3	12.5	16.3	20.2	10.2	10.4	12.4	17.1	13.8	11.2	11.8
17	Nonferrous metals	7.7	7.6	6.8	10.9	15.6	3.6	0.1	-2.7	0.7	2.1	4.6	7.4	10.3	4.5	8.6	10.6	10.3	10.0	9.9	7.7
59	Other metal prod.	13.0	11.0	11.1	14.6	17.7	9.9	4.9	0.5	6.2	9.1	9.5	11.0	10.7	4.9	9.9	11.5	13.7	10.5	10.3	10.8
20	Automobiles	25.7	26.9	24.3	27.7	25.5	8.9	4.0	-2.9	7.4	7.9	16.2	24.6	18.5	7.3	15.9	16.8	18.3	13.5	12.4	12.9
52	Auto trucks	18.0	14.8	12.0	23.0	23.5	6.7	-0.1	-4.8	0.1	6.1	16.3	16.6	17.9	1.1	12.8	17.2	19.9	16.7	17.6	15.5
52	Auto equipment	6.1	9.8	8.2	6.9	8.3	6.3	0.1	-1.8	-1.4	0.1	-0.1	3.7	7.6	-0.8	2.2	6.4	10.5	11.0	9.0	9.3
29	Railway equipment	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•
29	Aircraft and parts	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•	•
4	Shipbuilding	2.0	-5.0	0.4	3.5	6.1	0.4	-0.3	0.5	-1.0	0.3	-0.6	5.2	3.2	2.9	10.3	29.9	30.0	26.8	25.6	20.8
29	Misc. manufacturing	9.7	13.9	12.8	12.7	12.9	7.7	3.8	-0.4	5.9	8.7	10.0	13.7	12.7	8.6	9.2	11.7	12.4	11.2	10.6	10.9
1,327	Total manufacturing	10.7	10.8	9.0	11.6	12.8	6.4	2.3	-0.5	2.5	4.3	6.7	10.4	10.8	4.3	8.5	10.3	12.4	10.1	9.9	9.8

- Deficit. • Not computed because of limited number of reports available for the group.

Limitations of Published Reports

The sampling in our own tabulations varies widely among the various industries, with the broadest coverage in those lines requiring heavy capital investment per plant, such as steel, automobiles and petroleum, and the narrowest in those industries, such as textile products and apparel, composed for the most part of relatively small corporations, partnerships and proprietorships. There is often wide variation in earnings among the companies making up a single industry group, not revealed by composite totals and "averages."

The average annual rates of return shown over a period of years are not strictly comparable because of continual changes in the published reports tabulated each year. Our studies are not based upon a "selected" list but include all companies for which net income figures (final or estimated) are available by the end of March. A substantial turnover in the "business population" takes place every year, as old-established companies lose their position of leadership or disappear through liquidation, absorption by other companies, or reorganization under new names, and as new enterprises are established and push ahead.

In the first column of the summary is given the number of companies by industry groups for the year 1944, a total of 1,327. During the entire period the total number tabulated ranged from a high of 1,495 in 1940 to a low of 1,096 in 1932.

It should be borne in mind also that the industrial classifications are not in all cases clearly defined. Many companies overlap into different industries, and their assignment to the industrial groups from which they receive the major portion of their gross revenue causes some groups to be overstated and others understated. A particular "industry," as ordinarily defined, often contains several diverse branches and related lines, whose financial results are extremely mixed. Moreover, large numbers of companies must be shifted from one classification to another as the character of their business changes. During the war period, the usual peacetime industrial classification has in fact little meaning, since many companies have changed over completely to the production of war goods. In the years after the war, it is already clear, many companies will introduce major changes in types of product, and others will enter entirely new fields.

Other Factors Affecting Earnings

While rate of return on net worth is easily understood and widely used as a measure of earnings, it must of course be interpreted in light of all the factors involved. Depending upon capitalization and other circumstances, book net worth may be substantially above or below the "market value" or "fair value" of a

company. For many organizations the trade name and goodwill, built up through years of advertising and promotion expense, are worth far more than the plant, equipment, and working capital. In the beverage, drug and other fields, a relatively high rate of net income to tangible property, constituting in effect a return on the value of goodwill, is the rule. Moreover, when intangibles formerly carried in the balance sheet are amortized or written off entirely—as has been common practice during the past twenty years or more—the effect is to lower the book net worth and to automatically raise the percentage rate of return computed thereon. A similar effect comes from writing down valuations by reorganization and recapitalization.

Corporate earnings have been distorted materially by the unprecedented wartime demands, combined with factors such as rising costs, fixed selling prices, high taxes, and contract renegotiation. Large numbers of "marginal producers," operating before the war at nominal earnings or at deficits, have had a sharp rise in net income even after payment of steeply increased taxes. At the same time many other companies, which had a record of substantial and stable earnings, have experienced during the war a decrease both in net income after taxes and in dividends paid to shareholders. Manufacturing companies generally have had an expansion in volume to new high levels, but a marked decline in margins of net profit per dollar of sales.

The latter is often the most significant measure of real earnings for rapidly growing companies, which may expand their volume of business several-fold and sharply cut profit margins, yet because of the small invested capital base still show relatively high rates of return. The aircraft industry, for example, in order to meet the wartime demands, has been forced to expand on a scale probably unequaled in the industrial history of the world, and most of this expansion has been based upon borrowed money and on plants provided by the Government. The published reports of aircraft and parts manufacturers in our tabulations (numbering 29 in 1944) show a rise in the rate of return on net worth from 21.0 per cent in 1939 to a high of 48.8 per cent in 1941, followed by a decline to 23.6 per cent in 1944. The margin of net profit per dollar of sales, rose from 8.5c in 1939 to 13.1c in 1941. However, from that level it dropped steadily to an average of only 1.2c in 1944. When the war ends, the industry will face a tremendous curtailment and reconversion problem, and many companies will incur operating losses in the process which may cut deeply into their wartime earnings and reserves. These considerations illustrate the limitations, in certain circumstances, of return on net worth as a measure of earnings.



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